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No. 00-220

IN THE
SUPREME COURT OF THE UNITED STATES

THE HENRY E. & NANCY HORTON BARTELS TRUST FOR THE BENEFIT OF THE UNIVERSITY OF NEW HAVEN, Kenneth G. Bartels, John P. Loehmann, Philip H. Bartels, Marilou McLaughlin & Lawrence J. DeNardis, Trustees,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF OF THE PETITIONER

Contrary to the Government's assertion, plenary consideration of the writ of certiorari needs to be given, *first*, in order to rectify the direct conflict created by the decision below with the relevant decisions of this Court and, *second,* in order to resolve the square conflict among the evenly-divided Circuits on an important federal question. It is in this context that the Government has now raised two issues, and the resolution of each of these issues strongly supports the conclusion that the Petition should be granted.

1. A CAREFUL SCRUTINY OF THE 1950 AND 1969 CONGRESSIONAL REPORTS CONFIRMS THAT THE SOLE PURPOSE OF THE 1950 ENACTMENT OF THE UBIT, AND ALSO ITS 1969 AMENDMENT, WAS TO PREVENT AN EXEMPT ORGANIZATION'S UNFAIR COMPETITION AGAINST NON-EXEMPT TAXPAYERS.

The Government contends that their reading of the subject House and Senate Reports has revealed, with regard to the 1950 enactment of the Unrelated Business Income Tax (the "UBIT"), at Pub. L. No. 81-814, 64 Stat. 906, and also the 1969 Amendment thereto, Pub. L. No. 91-172, 83 Stat. 487, that there was, in addition to the UBIT's unquestioned purpose of the avoidance of unfair competition, a second purpose which was to raise revenues. (Gov. Br. 5 - 7 and 13). Of course, it is fundamental tax doctrine that the overall purpose necessarily of any comprehensive tax bill (such as the legislation that included the 1950 and 1969 UBIT enactments) is to cause a net increase in the revenues to the Federal fisc.

Thus, as would be expected, there is in the introductory, general statement sections of each of the 1950 and 1969 House and Senate Reports a summary discussion that includes the customary confirmation that, in net, the annual tax bill will increase Federal revenues. As such, however, these introductory sections do not provide any definitive guidance on the legislative history issue; instead, upon enquiry, it is only in the detailed explanatory sections that follow in each Report wherein the answer is found (and, fortunately, it is clearly stated) to resolve this legislative history issue.

More specifically, in each 1950 Report (S. Rep. No. 2375, 81st Cong., 2d Sess. (1950), pp. 504-06; H. Rep. No. 2319, 81st Cong., 2d Sess. (1950), pp. 408-09), and also in each 1969 Report (S. Rep. No. 552, 91st Cong., 1st Sess. (1969), *reprinted in* 1969-3 C.B., pp. 464-67; H. Rep. No. 413 (Part 1), 91st Cong., 1st Sess. (1969), *reprinted in* 1969-3 C.B. 228-230), the *raison d'être* for the 1950 UBIT enactment, and for its expansion in 1969 to include debt-financed income, is discussed in considerable detail. First, in the 1950 enactment of the UBIT, the narrow focus of Congress was made clear in each Report, as follows: "The tax-free status of these [exempt] organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes". (1950 S. Rep., at p. 504; 1950 H. Rep., at p. 409).[1] Most significantly, there is a total absence of any discussion

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[1] It is important to note that, specifically in the context of an exempt organization's receipt of capital gains income, the 1950 Senate Report concluded, at p. 506:

Dividends, interest, royalties, most rents, capital

in the explanatory sections of the 1950 Reports with respect to a revenue raising rationale for the UBIT.[2]

Similarly, the explanatory sections of the 1969 Reports do not discuss a revenue raising rationale for the 1969 expansion of the scope of the UBIT. Instead, the narrow reason for the enactment (1969 House Report, at pp. 228 - 29), which was discussed in considerable detail, was to halt a type of unfair competition that had been fostered by exempt

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> gains and losses, and similar items *are excluded* from the base of the tax on unrelated income because your committee believes that they are *"passive"* in character and are *not likely* to result in serious competition for taxable businesses having similar income. Moreover, investment-producing incomes of these types have long been recognized as a *proper source of revenue* for educational and charitable organizations and trusts. (Emphasis added).

It is beyond dispute that the Petitioner's margin trading income is a paradigm of this type of passive income.

[2] When Congress does have revenue raising as its purpose for enacting a particular provision of a tax bill, it deliberately says so. For example, in connection with the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312, the revenue raising purpose of the amendment therein to Section 162(e)(1) (entitled: "Denial of deduction for lobbying expenses") of the Internal Revenue Code of 1986, as amended, 26 U.S.C. §162(e), was dispositively stated in the "Reasons for Change" section of H. Rep. No. 111, 103rd Cong., 1st Sess. (1993), *reprinted in* 1993 - 3 C.B. 235, as follows: "The committee has determined that, in the context of deficit reduction legislation, it is appropriate to limit the deduction for lobbying expenses".

organizations, *viz*., a tax device developed by business owners which had permitted them to recharacterize their ordinary income from their business as capital gains:

> This provision will *discourage* a developing device . . . the net effect [of which] is the use of the tax exemption to reduce taxes for the owners of a business by converting ordinary income to capital gain and eventually to acquire a business for a tax-exempt organization entirely out of the earnings of that business. (Emphasis added).

(The 1969 House Report, at p. 229, characterizes this business owners' tax conduct as a "*Clay Brown* situation", in a reference to *Commissioner v. Clay B. Brown,* 380 U.S. 563 (1965).)

The method by which this narrow purpose of the 1969 Amendment was to be accomplished is the following (which purpose and method are made clear when the entire paragraph from the 1969 House Report, at p. 230, from which the Government has quoted only the first sentence (Gov. Br. 7), is now fully read):

> Your committee believes that this type of transaction with its damaging consequences to the Federal revenues as well as its potential for unfair business competition should be discouraged. It believes the way to do so is by *eliminating the incentive for owners* desiring to sell a business to exploit the tax exemption of non-profit organizations. *The objective* can be achieved by imposing the unrelated business income tax on the income received by the

> exempt organization in proportion to the debt existing on the income- producing property. (Emphasis added).

Distilling the foregoing two citations to the 1969 House Report, at pp. 229-230, the following conclusions are readily apparent: (i) the purpose of the 1969 Amendment was to effectively close the loophole of the business owners' manipulation of an exempt organization, which had fostered unfair competition; (ii) in order to avoid this second, but indirect, §514(a) tax (all section references hereinafter are to the Internal Revenue Code of 1986, as amended, 26 U.S.C. §§1, *et seq.)* upon the business owners, it would be expected that they would cease conducting their business via a *Clay Brown* structure, and would once again pay taxes at the ordinary income rates on the earnings from their businesses; and (iii) no tax revenues would be expected to be raised from exempt organizations by means of the §514(a) tax.

This conclusion with regard to this singular, anti-unfair competition purpose of the 1950 and 1969 Enactments is strongly reinforced in this Court's three UBIT decisions, *Portland Golf Club v. Commissioner*, 497 U.S. 154 (1990), *United States v. American Bar Endowment*, 477 U.S. 105 (1986), and *United States v. American College of Physicians*, 475 U.S. 834 (1986). First, this Court never cited *Clarence LaBelle Post No. 217 v. United States*, 580 F. 2d 270 (8th Cir. 1978), *cert. dismissed* 439 U.S. 1040 (1978), which is relied on so heavily by the Government (Gov. Br. 6-7), nor did this Court even address the position that there could be a second, and revenue raising, purpose to the 1950 and 1969 Enactments. Moreover, in this Court's numerous citations in its UBIT decisions of the relevant sections of the 1950 and 1969 House and Senate Reports, there was no reference therein to any aspect of revenue raising. The reason for this

absence of such a discussion in the House and Senate Reports was squarely reconfirmed in *Portland Golf Club*, 497 U.S. at 161-62:

> Taxes are levied on "unrelated business income" *only* in order to prevent tax-exempt organizations from gaining an unfair advantage over competing commercial enterprises. See *United States v. American College of Physicians*, 475 U.S. 834, 838 (1986) ("Congress perceived a need to restrain the unfair competition fostered by the tax laws"). (Emphasis added; Footnote omitted).

Quite simply, it was as Congress had stated with clarity, and as this Court repeatedly confirmed in its three UBIT decisions, that the sole purpose of the UBIT was to put an end to unfair competition by exempt organizations.

2. THE WIDE NET RULE OF STATUTORY CONSTRUCTION, WHICH IS RELIED ON BY THE GOVERNMENT, IN FACT REINFORCES THE CONCLUSION THAT THE PETITIONER'S PASSIVE INCOME IS OUTSIDE THE TAX POLICY OF THE UBIT.

The Government curiously relies on the "Wide Net" Rule of statutory construction, *viz.*, that "the reach of a statute often exceeds the precise evil to be eliminated". *Brogan v. United States*, 522 U.S. 398, 403 (1998). (Gov. Br. 8). In *Brogan* and the other two decisions of this Court cited by the Government, this Court applied the Rule in order to include

within the scope of each of the subject statutory prohibitions a wide range of "evils". In *Brogan*, for example, the evil was making false statements during federal bribery investigations. In *Oncale v. Sundowner Offshore Services, Inc.*, 523 U.S. 75 (1998), the evil was sexual harassment. Finally, in *Moskal v. United States*, 498 U.S. 103, 110 (1990), the evil was an interstate scheme of altering car titles by rolling back mileage figures: "We think 'title-washing' operations are a perfect example of the 'further frauds' that Congress sought to halt in enacting [18 U.S.C.] §2314". The underlying rationale in these decisions for an expansive reading of the prohibitory statutes was to ensure that undeniably wrongful conduct would not escape the reach of the statutory net.

Conversely, however, the Petitioner's passive conduct (*i.e.*, receiving income from its securities trading on margin) is a far cry from the broad category of unfair competition that the tax policy of the UBIT is meant to eliminate. In fact, the Petitioner's conduct not only is the antithesis of unfair competition, but it is even beneficial to the securities markets (a fact deemed admitted in this case - *See* Pet. 5). Indeed, unlike the clearly reprehensible conduct at issue in *Brogan* and the related two decisions of this Court, it is beyond question that there is no risk of the Petitioner's conduct running afoul of the purpose of the UBIT. In sum, the Wide Net Rule reinforces the simple fact that the Petitioner's income is "outside the objects and policy" of the UBIT, *Cf. Brown v. Duchesne*, 19 How. 183, 194 (1857), and thus it does not constitute §514(a) taxable income.

CONCLUSION

For the foregoing reasons and those stated in the Petition, a writ of certiorari should be granted in order that

plenary consideration can be given to this important federal question.

• Dated: October 18, 2000

Respectfully submitted,

/s/_____

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